



Operations Summary

Year Ended June 30, 2004

California Public Employees' Retirement System

A large, high-quality photograph of a single water drop hitting a surface, creating a series of concentric ripples. The drop is captured in mid-air, just above the point of impact, with a small splash visible. The background is a deep blue, and the ripples are clearly defined against the surface.

ripple effects

calpers profile

The California Employees' Retirement System (CalPERS) is the nation's largest public pension fund and the second largest in the world, with assets at June 30, 2004 of approximately \$167 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1.4 million people and more than 2,500 public employers. The System also operates eight Regional Offices located in San Francisco, Glendale, Orange County, Fresno, Sacramento, San Bernardino, San Diego, and San Jose.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 1,002,067 active and inactive members from the State, school districts, and local public agencies, and 413,272 retirees, beneficiaries, and survivors. Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees' Medical and Hospital Care Act. Local public agencies joined in our Health Program on a contract basis five years later.

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California Public Employees' Retirement System

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**Sean Harrigan, President
CalPERS Board of Administration**

president's message

It is an honor to present the CalPERS Operations Summary and Comprehensive Annual Financial Report for the fiscal year ended June 30, 2004.

It is with great pride that I look back at the accomplishments of our more than 1,600 employees who have contributed over the past year toward our strong financial performance. The ripple effect of their achievements earned us a solid 16.6 percent return on investments; that's the best performance for a single fiscal year since the mid-1990s. Our results provide continued evidence of the underlying strength of our System. In addition to our financial performance, we made great strides in the overall quality of our services and administration of retirement and health benefits delivered to our members, employers, and stakeholders.

Fiscal year 2003-04 was an important one for us; we stayed focused and true to our Strategic Plan. We continued to build upon our alliances and strong relationships with other institutional investors to influence Corporate America, and Wall Street, for more integrity in corporate bookkeeping, and more independence in corporate boards of directors.

During the year, we made significant strides in health care reform. We worked in a variety of ways to tackle the drivers of health care cost increases. We aggressively negotiated with HMOs and narrowed our hospital network to exclude some high-cost hospitals. We explored alternative benefit designs and better methods to manage prescription drug benefits.

It was also a year of major achievements in terms of improving customer service. We unveiled a new feature online to calculate the purchase of Additional Retirement Service Credit. We launched a new consolidated toll free telephone number for our members and contracting employers. We also redesigned and upgraded our CalPERS On-Line Web site to provide our members and employers information that is tailored just for them.

As we look ahead, we will continue to work hard to seek high investment returns while carefully managing risk. Our members, beneficiaries, and employers will see continued improvements in financial strength, retirement and health care stability, and service. We look forward to building upon our success of this past year and upon our strong financial foundation created over the past 73 years.

Sincerely,

A handwritten signature in black ink, appearing to read "Sean Harrigan". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

**Sean Harrigan, President
CalPERS Board of Administration**

introduction

Providing Capital to Promising Private Companies — The Ripple Effect



Investing in private companies brings diversity to our portfolio, and enables us to achieve high returns for our members. A key part of our investment portfolio is our Alternative Investment Management Program (AIM).

The AIM program helps to finance the future of promising companies in California and around the world. The program has invested and committed more than \$21 billion and has helped thousands of companies grow.

These investments have a ripple effect on the people and businesses in many of California's growing regions. For example, our capital enabled a consumer goods company in San Francisco to offer solid wages and health insurance to low and moderate income workers. As this small company grows, the products and services it purchases from other businesses will further benefit the local economy.

We recognize that the private sector offers outstanding investment opportunities and is a cornerstone of our nation's economy. We will continue to play a leading role in helping private companies grow.



growing companies

introduction

As the nation's largest public pension system, we are entrusted to secure and advance the financial, retirement, and health security of our more than 1.4 million members.

One way we achieve our goals is to invest in our home state, California. Investments in California serve the broad interest of our beneficiaries, and have an ancillary benefit of creating jobs, housing, and improvements to the general infrastructure. We invest in all market sectors of California's economy, from agriculture, manufacturing, science, technology, home building, to real estate. It all adds up to a positive impact on the Golden State.

It also strengthens the State's economy and the well being of employers, helping to promote the continued ability of employers to make contributions to our System.

On the following pages of this Operations Summary, you will find stories about our investments in California and how they benefit our members, employers, and all Californians. The ripple effect that is created by our investments strengthens our members' retirement security and strengthens our State's economy.

Although CalPERS manages 14 funds, the Operations Summary highlights the financial activities of the Public Employees' Retirement Fund, our primary operating fund. Information regarding our other funds is included in our Comprehensive Annual Financial Report (CAFR). The Operations Summary serves as a supplemental booklet to the CAFR and both are available on our Web site at www.calpers.ca.gov.

financial highlights

Public Employees' Retirement Fund¹

(Dollars in Thousands)

	2004	2003
Assets		
Cash & Cash Equivalents	\$312,032	\$400,166
Investments at Fair Value	194,916,574	170,095,273
Receivables	3,136,877	2,370,550
Other Assets	267,510	169,751
Total Assets	\$198,632,993	\$173,035,740
Liabilities	\$31,048,894	\$28,273,034
Net Assets Held in Trust for Pension Benefits	\$167,584,099	\$144,762,706

Additions & Deductions

	2004	2003
Additions		
Member Contributions	\$2,266,445	\$1,887,925
Employer Contributions	4,261,347	1,925,044
Net Investment Income	24,265,850	5,474,084
Other	6,723	8,648
Total Additions	\$30,800,365	\$9,295,701
Deductions		
Retirement, Death & Survivor Benefits	\$7,639,085	\$6,991,914
Refunds	151,526	114,025
Administrative Costs	188,361	214,274
Total Deductions	\$7,978,972	\$7,320,213
Increase in Net Assets Held in Trust for Pension Benefits	\$22,821,393	\$1,975,488

Complete financial information on all the funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 2004.

Note:

- ¹ Differences in the amount shown for investment assets in these financial highlights and the investment portfolio amount reported in the Investments Section of this summary are due to differences in reporting methods. In accordance with Governmental Accounting Standards Board Statement No. 28, the financial statements include securities lending collateral. In addition net investment receivables/payables are not included here.



*Top row (from left to right): Sean Harrigan, Rob Feckner.
Second row (from left to right): Sidney L. Abrams,
Philip Angelides, Willie L. Brown, Jr., Robert F. Carlson.
Third row (from left to right): George Diehr, Priya Mathur,
Michael Navarro, Mike Quevedo, Jr.
Fourth row (from left to right): Kurato Shimada,
Charles P. Valdes, Steve Westly.*



calpers board of administration

Sean Harrigan, President

State Personnel Board Member
(designated by the State Personnel Board)
Term Ends: December 31, 2004

Rob Feckner, Vice President

Employee Member
(elected by school members)
Glazing Specialist, Napa Valley
Unified School District
Term Ends: January 15, 2007

Sidney L. Abrams

Official of Life Insurer¹
Trustee, United Food and Commercial Workers
Unions and Employers Midwest Health Benefits
Fund and Pension Fund
Term Ends: January 15, 2005

Philip Angelides

State Treasurer
Ex Officio Member

Willie L. Brown, Jr.

Elected Official of Local Government¹
Former Mayor of San Francisco
Term Ends: January 15, 2007

Robert F. Carlson

Retired Member
(elected by retirees)
Retired, Chief Counsel,
Department of Transportation
Term Ends: January 15, 2008

George Diehr

Employee Member
(elected by State members)
Professor, CSU San Marcos
Term Ends: January 15, 2007

Priya Mathur

Employee Member
(elected by public agency members)
Economist, Bay Area Rapid Transit
Term Ends: January 15, 2007

Michael Navarro

Director, Department of Personnel Administration
Ex Officio Member

Mike Quevedo, Jr.

Public Representative²
Term Ends: January 15, 2008

Kurato Shimada

Employee Member
(elected by all members)
Retired, Supervisor of Operations,
Oak Grove School District
Term Ends: January 15, 2006

Charles P. Valdes

Employee Member
(elected by all members)
Counsel, Department of Transportation
Term Ends: January 15, 2006

Steve Westly

State Controller
Ex Officio Member

Notes:

¹ Governor appointee.

² Appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.

calpers board committees

In addition to their regular duties, Board Members also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 2004.

Benefits & Program Administration

Kurato Shimada, Chair

Sidney L. Abrams, Vice Chair

Robert F. Carlson

George Diehr

Rob Feckner

Sean Harrigan

Priya Mathur

Michael Navarro

Steve Westly

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

Health Benefits

Sidney L. Abrams, Chair

George Diehr, Vice Chair

Philip Angelides

Rob Feckner

Sean Harrigan

Priya Mathur

Michael Navarro

Charles P. Valdes

Steve Westly

This committee oversees the administration of the Public Employees' Medical & Hospital Care Act program and the Public Employees' Long-Term Care Act program.

Performance & Compensation

Charles P. Valdes, Chair

Robert F. Carlson, Vice Chair

George Diehr

Rob Feckner

Priya Mathur

Kurato Shimada

Vacancy

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

Finance

Robert F. Carlson, Chair

George Diehr, Vice Chair

Philip Angelides

Willie L. Brown, Jr.

Priya Mathur

Charles P. Valdes

Steve Westly

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.

Investment

Rob Feckner, Chair

Priya Mathur, Vice Chair

Sidney L. Abrams

Philip Angelides

Willie L. Brown, Jr.

Robert F. Carlson

George Diehr

Sean Harrigan

Michael Navarro

Mike Quevedo, Jr.

Kurato Shimada

Charles P. Valdes

Steve Westly

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

Investment Policy Subcommittee

Charles P. Valdes, Chair

Philip Angelides, Vice Chair

Robert F. Carlson

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee and reviews and recommends revisions to these on a priority basis. It is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

R Street Subcommittee

Charles P. Valdes, Chair

Robert F. Carlson, Vice Chair

Priya Mathur

Rob Feckner

Kurato Shimada

This subcommittee oversees the CalPERS headquarters expansion project, including the selection of contractors, approval of building designs, and approval of expenditures and budgets.



*Top row (from left to right): Fred Buenrostro,
Gloria Moore Andrews.
Second row (from left to right): Mark J.P. Anson,
Allen Goldstein, Jarvio A. Grevious, Patricia K. Macht.
Third row (from left to right): Peter H. Mixon,
Ronald E. "Gene" Reich, Ron Seeling, Anne Stausboll.
Fourth row (from left to right): Kathie Vaughn,
Robert D. Walton.*



calpers executive staff

Fred Buenrostro

Chief Executive Officer

Gloria Moore Andrews

Deputy Executive Officer
Operations

Mark J.P. Anson

Chief Investment Officer
Investment Office

Allen Goldstein

Assistant Executive Officer
Planning & Organization
Development

Jarvio A. Grevious

Assistant Executive Officer
Health Benefit Services
(Loren Suter through March 2004)

Patricia K. Macht

Assistant Executive Officer
Public Affairs

Peter H. Mixon

General Counsel

Ronald E. “Gene” Reich

Assistant Executive Officer
Information Technology Services

Ron Seeling

Chief Actuary
Actuarial & Employer Services

Anne Stausboll

Assistant Executive Officer
Investment Operations

Kathie Vaughn

Assistant Executive Officer
Member & Benefit Services
*(Barbara Hegdal through
April 2004)*

Robert D. Walton

Assistant Executive Officer
Governmental &
Administrative Services

division chiefs

Nancy Carter

Member Services

Sandra Felderstein

Office of Decision & Program
Support Services

Tom Fischer

Health Benefit Services

Holly Fong

Fiscal Services

Tim Garza

Enterprise Modeling
& Management

Pat Harris

Branch Development Center

Vacant

Office of Policy &
Program Development
*(Linda Hoff through
November 2003)*

Greg Hood

Investments & Administrative
Services Operations

Curtis Howard

Office of Employer & Member
Health Services

Larry Jensen

Office of Audit Services

Ron Kraft

CalPERS Customer
Contact Center

Jeff Lung

Office of Information Security

Ken Marizon

Actuarial & Employer Services

Carol McConnell

Deputy General Counsel
Legal Office

Dave Mullins

Supplemental Savings Program

Rick Nelson

Operations Support Services

Karen Neuwald

Office of Governmental Affairs

Chris Nishioka

Benefit Services

Michael Ogata

Strategic Business
Development Office

Pat Chappie

Human Resources
(Tom Pettey through June 2004)

Diana Proctor

Headquarters Expansion Project

Terri Westbrook

Office of Health Policy &
Plan Administration

regional office managers

Anita Commer

San Francisco

June Copple

San Bernardino

Laura Duran

Orange County

Elaine Edwards

San Diego

Debra Gibson

Sacramento

Edith Mercer

Glendale

Elwin Nash

Mountain View

Steve Pietrowski

Fresno

the year in review

Impact of New Homebuilding Ripples Across the State's Economy



Our extensive investment in real estate development continues to provide solid returns, while having an economic ripple effect throughout the State. That impact is illustrated on a small scale in Riverside, California.

Initially, the construction fees paid to municipalities finance public services, many of which are provided by our members. The project, Township Place development, created jobs for dozens of small business subcontractors and hundreds of workers. The local economy benefits as these individuals spend their wages.

The 282 homes in the development will provide reasonably priced housing in a region where prices are out of reach for many individuals. These new homeowners will continue to contribute to the economy by purchasing products and services for their homes. And, as the region's population grows, the need for other services will increase, spurring retail development and further construction, and providing opportunities for local entrepreneurs.

New housing construction is a vital part of our State's economy. We are pleased to be able to invest in such projects for the benefit of our members, our employer groups, and all Californians.



creating homes

the year in review

We take our responsibilities as guardians of the nation's largest public pension fund seriously. Although in fiscal year 2003-04, we saw signs of an upturn in the U.S. economy and the State's fiscal situation slowly beginning to recover, we knew we still faced a very difficult financial environment.

We continued to focus on our mission and understood that success rarely comes without hard work and determination. On the following pages, you will see the results of our efforts this past year.

In the 2003-04 fiscal year, we made significant strides in our investment returns, positioning ourselves for the capital market's ebbs and flows, and we realized dramatic increases, outperforming other comparable indexes, and beating our own benchmarks. We aggressively fought to rein in escalating costs in the health care market by significantly moderating health care premiums to a more sustainable level, well below the national average. We also made great strides in improving our benefit administration and our customer service.

Managing Our Benefits

In fiscal year 2003-04, we made great progress toward accomplishing many of our major Strategic Plan initiatives by remaining focused on our mission — managing benefits, providing quality service, and prudently managing our assets.

We continued to fine-tune and strengthen our connection to all of our constituents. Our members and employers relied on us to understand their goals, provide solutions, and demonstrate results. We achieved this by exploring and implementing more cost-effective and efficient ways to provide customer services. We also made enhancements to our Web-based business services and streamlined our core

business processes. These actions created more value for our members, employers, and stakeholders.

During the year, our core workload increased. We processed 22,949 new service retirements and paid out more than \$7.6 billion in retirement, death, and survivor benefits, up from \$7 billion the previous year. Ninety-seven percent of our newly-retired members received their first benefit check within 30 days of their retirement date. In addition, we processed 28,150 requests for refunds and expedited those refunds to members within 30 days. Staff also completed 4,296 disability retirement determinations and processed 50,000 requests for direct deposit of retirement checks.

We also processed more than 98,000 retirement estimates, an increase of 10,000 more than the previous year. We provided assistance to 63,390 visitors to our Regional Offices, completed 687 retirement sessions at employer sites, and conducted more than 1,400 financial planning seminars and retirement planning workshops.

We made significant progress in reducing our Additional Retirement Service Credit elections (ARSC) inventory. This past year, we established a dedicated team focused on reducing the number of outstanding ARSC.

Providing Customer Service

Providing high-quality customer service is one of our key core objectives. This past year, we achieved a major milestone in our ongoing effort to respond faster and provide more efficient customer service. We launched a consolidated toll free telephone number for all customer service calls for CalPERS members and employers — (888) CalPERS (225-7377).

CalPERS members and representatives of contracting employers now call one easy-to-remember number for assistance. Our Interactive Voice Response (IVR) system routes member calls to our Customer Contact Center and employer calls to our Employer Contact Center. Specially-trained agents are on hand to answer questions and provide assistance. When an issue is especially complex or technical, the call is referred to a staff expert for assistance. Every effort is made to assist the caller during their initial contact, resulting in more immediate service.

Both Contact Centers began using new technology tools to enhance customer service. The “Inquiry Workflow” system converts paper correspondence and hard-copy documents into an electronic format and automatically routes them to the Contact Centers for member or employer customer service. The “Customer Relations” system allows us to capture and manage customer inquiries regardless of what communication channel our customer used — telephone, written correspondence, electronic mail, or walk-in. The two systems enable faster and more efficient customer services for all our members and employers.

Our IVR system is also available 24 hours a day to members who want to request publications or listen to frequently asked questions or special announcements on topics such as the issue date of benefit checks, refunding member contributions, or purchasing service credit.

Our telephone service is just one communication channel in which members could conduct CalPERS business. The other is our Web site. In fiscal year 2003-04, well over 46 million visitors accessed our Web site.

As the demand for better and faster services increases our members become more proactive in taking charge of their retirement investment and use the Internet to obtain information and transact business.

In March 2004, we launched our new CalPERS On-line Web site. The most significant feature of the new site is the ability for our members and employers to get customized information that is relevant only to them. By answering a few basic on-screen questions, they can create a member or employer “view.” For example, active State members only see information about the benefits they are eligible for. They don’t see information that is relevant only to public agency and school employees or retirees, and vice versa. The same thing applies to our employers.

We continue to offer members extensive online informational resources and services. Members can access their personal retirement account information and perform certain business transactions online. For example, a member can submit a change of address or use the Retirement Planning Calculator with their specific information automatically programmed in, quickly and easily. This major upgrade of our Web site is the start of our continuing commitment to enhance and expand services to our members and employers.

20 The Year in Review

In December 2003, as a result of new legislation allowing active CalPERS members to purchase Additional Retirement Service Credit toward their retirement, we expanded our online service. The “Service Credit Cost Estimator,” allowed members to determine the cost for ARSC service credit purchases. This online service expands our growing list of options of services including requesting official CalPERS retirement estimates, viewing an Annual Member Statement, registering for a seminar or workshop, and ordering online publications, forms, or a CalPERS video.

All our online services offer a secure environment and require members to register by choosing a User ID and Password online to ensure protection of their electronic information assets.

Another channel of communication we used to stay connected with our members, employers, and other interested parties is our bimonthly e-Newsletter — *CalPERS eNews* — available by subscription. More than 5,000 subscribers received breaking news on corporate governance campaigns, new investments, retirement issues, legislation, and more. In addition, we have an online Press Room that gives the news media direct access to news releases, breaking news, and facts about CalPERS.

Working with our staff to build customer relationships with our members and delivering the services they need to help them achieve their dreams of financial security is paramount. Every year, we host Retirement Planning Month — an event held to educate members about the value of their CalPERS defined benefit plan, their Social Security benefits, and their options for growing their own personal savings. This year’s event was unique because it featured hosting open houses at each one of our eight regional offices located throughout the State, and three other locations as well.

More than 5,000 visitors attended one of these events, an increase of 3,000 from the previous year. In addition, members had an opportunity to talk with our financial planning partner, American General Financial, to further assist them with their retirement planning. Each member received a special retirement planning calculator and a portfolio to keep all their important CalPERS information.

Members were able to meet with our staff and talk about their retirement benefits and financial planning opportunities, and learn more about our other programs and services, such as our Member Home Loan and Long-Term Care Programs. We also had special information for our retired members because secure financial planning does not end at retirement. Our Retirement Planning Month has proven to be popular with our members in presenting information directly to them year after year.

Retirement Program Highlights

- 1,002,067 active & inactive members
- 413,272 retirees, beneficiaries & survivors
- 24,563 new service & disability retirees
- \$7.6 billion paid in benefits
- 2,560 public agency employers (including school districts)

Continuing to educate our members about their financial future is priority for us. That is why in addition to our educational programs, we provided members another innovative way to access financial information through the Online Financial Planning Center on our Web site. This electronic classroom provides five different financial planning courses from cash and risk management to determining their investment type and developing investment strategies. Members can also find help on estate, insurance, and retirement planning. To request a personal financial plan, members can contact a financial advisor online.

CalPERS Supplemental Savings Program

The CalPERS Public Agency 457 Deferred Compensation Program, which is available to local public agency and school members, welcomed an additional 1,645 new participants and 35 new agencies this past fiscal year. The program now has 17,332 members and 489 participating employers. Assets totaled \$371.1 million at year end, a 32.7 percent increase from the previous year. Contributions and transfers received were \$74.1 million and distributions and withdrawals paid to participating plan members were \$16.1 million.

The State Peace Officers' and Firefighters' Defined Contribution Program realized plan growth for its 34,903 participants. This employer-paid program is available to certain eligible State safety members. Net assets increased by 40.5 percent to \$189.2 million at June 30, 2004. Benefits paid out during the year were \$4.4 million and contributions increased 16.7 percent to \$40.9 million.

The CalPERS Supplemental Contributions Program is a voluntary supplemental savings plan available to State members and is entirely member funded. Contributions are made on an after-tax basis. At the end of fiscal year 2003-04, there were 1,010 participants and assets were valued at \$20.4 million. Contributions were \$700,000 for the year, and \$1.6 million was paid in participant withdrawals.

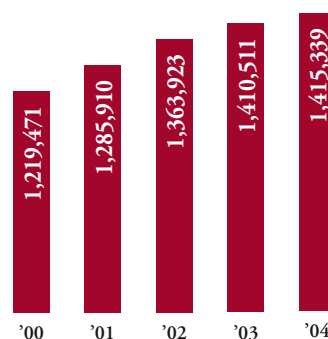
CalPERS Member Home Loan Program

For more than 20 years, we have offered our members security, protection, and choice when purchasing or refinancing a home through our innovative Member Home Loan Program.

Available nationwide, this program continued to offer our members free 60-day interest rate protection coupled with two float down opportunities. This feature allows members to receive the lowest interest rate as of the date of rate lock-in, date of loan approval, or date the loan documents were drawn. The program controls lender closing costs (including points that brokers charge) and offers a very competitive rate on the variety of loan options.

Total CalPERS Membership

Five-Year Review



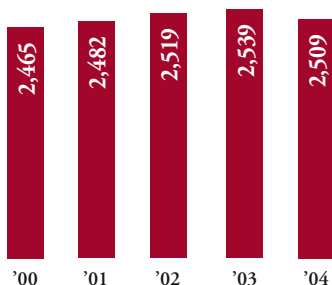
22 The Year in Review

This past year, the Member Home Loan Program added a few more features such as a 5/1 adjustable rate mortgage, four new second mortgages which provide members 100 percent financing opportunities, and a suite of first-time homebuyer products designed with our members' special needs in mind.

A newly-adopted automated underwriting enabled our network of approved mortgage lenders to render same-day loan decisions without having to go through a review process. The Member Home Loan Program funded 12,816 real estate loans totaling \$2.3 billion last fiscal year.

We believe in making the dream of owning a home a reality and by increasing the opportunities of homeownership for members, in a market of skyrocketing housing prices, we not only have a positive effect on the people who work and live in our communities, but also create a ripple effect that benefits our State as a whole.

CalPERS Participating Public Agencies Five-Year Review



Building Employer Relationships

The fourth annual CalPERS Educational Forum, *Connections*, offered an exceptional opportunity to build stronger employer relationships. Employers assist us in administering benefits to their employees. Our Forum was held October 20-22 at the San Francisco Hilton Hotel, and more than 480 employer representatives participated in the event.

This past year's Forum focused on our continued efforts to improve services to meet our employers' rising needs. Workshops concentrated on three topic areas: daily administration, future direction, and helping your employees. These sessions enhanced learning and information sharing with our employers on issues affecting pension costs, new legislation, disease management, financial reporting, and assisting their employees.

During the 2003-04 fiscal year, we completed an actuarial experience study. The study focused on recent patterns of termination, death, disability, retirement, and salary increases. As a result, our Board of Administration adopted new demographic assumptions that would affect employers' contribution rates.

In addition, our Actuarial Office worked diligently to help dramatically reduce or eliminate large fluctuations in the employer's contribution rate caused by unexpected demographic events. By implementing regulations, we laid the groundwork to develop risk pools and establish criteria for participation.

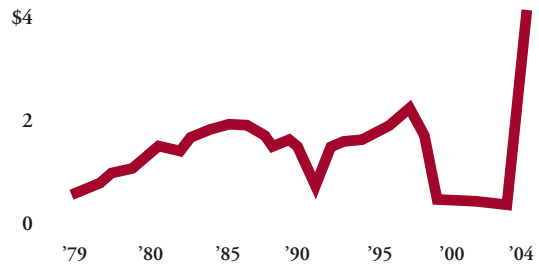
With the establishment of our Employer Contact Center, we streamlined employer customer service. Our employers can reach specially-trained representatives who answer a variety of questions about our programs. Our representatives also process business transactions online for employers. In fiscal year 2003-04, the Employer Contact Center provided service to more than 92,000 callers on their initial point of contact with us.

Employer education efforts during the year included training and education on our business functions and programs. More than 329 employers received our Automated Communication Exchange System (ACES) hands-on training through 91 sessions held across the State. We also conducted 65 school and public agency workshops for over 313 employers, reaching more than 1,380 attendees. We educated 139 State agencies during 56 workshops for more than 736 State staff. In addition, staff delivered 33 special request workshops for 203 agency staff to meet those employers' unique needs.

ACES, which allowed employers to submit electronic health benefits, membership, and payroll transactions via the Internet, continued to expand with 418 new participating employers. This online business system significantly reduced the volume of paper we receive. Paperless transactions post timely and resulted in our members receiving services faster than before.

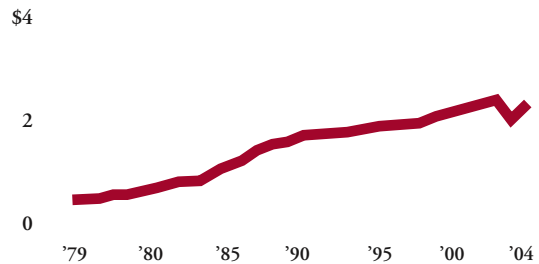
CalPERS Income from Employer Contributions

25-Year Review
(Dollars in Billions)



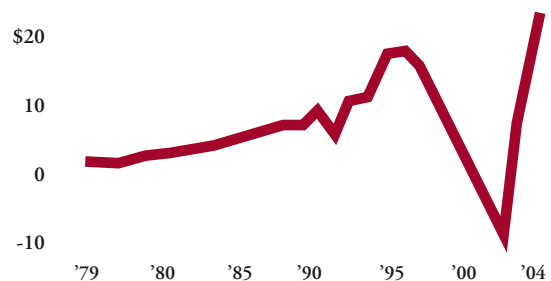
CalPERS Income from Member Contributions

25-Year Review
(Dollars in Billions)



CalPERS Income from Investments

25-Year Review
(Dollars in Billions)



This past year, staff converted 2.4 million employer records from paper to electronic images. We also completed and mailed 1,934 public agency valuation rates on schedule, processed more than 113,000 member transactions submitted by employers, 45,000 payrolls, and completed more than 260 public agency contract amendments. In addition, staff performed 3,418 member record compensation reviews — a 23 percent increase from the previous fiscal year.

Improving Our Organization Effectiveness

This past year, we continued to work on our technology and networked environments, developing new products, improving the effectiveness and efficiency of our existing technology, and we looked for ways to bring employees, members, and employers together in new and more effective ways.

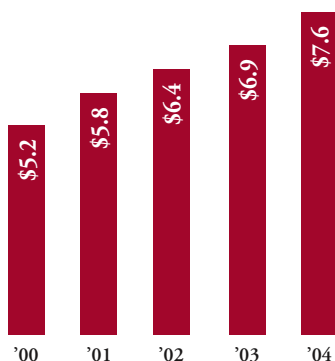
We made many technological improvements, ranging from implementation of our new CalPERS On-Line Web site, the Health Care Decision Support — a support system that enabled our Health Program to provide comprehensive utilization and cost information for all plans that contract with us, and completed an internal migration of staff's desktop computers to Windows XP.

Information security is a top priority at CalPERS. Within our organization, we have a special CalPERS team specifically devoted to this function so we can ensure all our information assets are protected and member personal information remains secure. This past year, through efforts by our employees and with the help of anti-virus software, we prevented thousands of viruses from invading our computer systems.

In addition, our internal and field audit programs at CalPERS increased assurances that our member assets were safeguarded, operating efficiency was enhanced, and compliance was maintained within prescribed laws, and management policies. During the year, the Office of Audit Services completed 40 public agency audits, provided consultation on 18 more projects, and completed 24 internal audits, as well as 20 health, real estate, and other contracted audits.

CalPERS Benefits Paid

Five-Year Review
(Dollars in Billions)



CalPERS is a major source of contracts for many businesses. During the year our CalPERS Business Connection, an outreach and marketing program geared toward potential business partners, ensured that our procurement processes were widely known by the business community by conducting regular contracting workshops to better educate those who were interested in doing business with us. Our CalPERS On-Line lists all current available business opportunities.

It has been a full and busy year, and we could not have accomplished our many successes without the hard work of staff, who continued to demonstrate outstanding levels of performance this past year. We recognize their tremendous dedication and contributions toward advancing the CalPERS vision.

CalPERS continued to be an employer of choice that attracted and retained highly capable and motivated professionals. This past year we focused on creating training and development opportunities for all levels of staff to address feedback obtained through our 2002 All Employee Survey.

Our managers and supervisors were offered a three-tiered progressive leadership series, including “L.E.A.D.E.R.” for newly-appointed managers and supervisors; “Lead by Example” for experienced supervisors who manage projects, a program, or front-line staff; and “Maximum Results” which focused on situational leadership. Participants honed their analytical skills by attending the “Essentials for Employee Excellence (E-3)” series of courses. We also initiated a number of courses as part of a new career development series for staff interested in furthering their careers. Additionally, the initial phases of a comprehensive “Succession Planning and Management” program were introduced.

In the past year, our employees have worked to improve local communities through their involvement with nonprofit organizations. Staff continued to increase our annual charitable contributions by 14 percent from the previous year. We also received the Star Fundraiser Award that is presented to the State agency with the highest single fundraising event for the California State Employees Charitable Campaign. In addition, staff donated more than 102,000 pounds of food to the State Employees’ Food Drive, receiving the top honors for the total highest overall donations for the third year in a row, and donated 359 pints of blood with our various blood drives throughout the year.

Headquarters Expansion

Work progressed at a steady pace on our Headquarters Expansion Project and remains on schedule for completion in Spring 2005. The mixed-use complex, adjacent to our existing building, will include a building with a six-story west wing and a four-story east wing, an 18,000-square-foot public courtyard, parking, retail shops, a restaurant, and the relocation of our day-care center. The office space will provide room for our staff as CalPERS continues to grow to meet our member needs. It will also make a significant contribution to the Sacramento community, creating a neighborhood that connects work and living spaces in a way that improves the city and is consistent with the city’s R Street Corridor planning policy, including plans for 180,000-square-feet of residential development.

Feedback & Recognition

As the nation's largest public pension fund, CalPERS is especially proud to receive another "Certificate of Achievement for Excellence" for financial reporting from the Government Finance Officers Association this past year.

At a ceremony held in May 2004, 24 CalPERS employees were honored as the 2004 APEX nominees. The APEX (Achieving Performance EXcellence) is our peer-driven formal recognition program that acknowledges those employees who demonstrate commitment to the CalPERS core values, our customer service principles, excellent technical and interpersonal skills in ongoing pursuit of self-development, and to the overall success of CalPERS.

In addition, CalPERS was named one of the region's top workplaces for commuters for meeting the National Standard of Excellence in commuter benefits, received two prestigious awards for excellence in using information technology to improve government services by the National Association of State Chief Information Officers. Our Opportunistic Portfolio Manager was awarded the Third Annual Stephen Dimino and Ian Schneider "Beneficial Owner of the Year" for leadership in securities lending. And we received a Grand Award from the APEX 2004 Awards for Publication Excellence for our video and electronic publication, *Healthcare 101: What you need to know about prescription drugs*.

calpers health & long-term care

Helping Seniors Contribute to Their Community



Recognizing the increasing need for assisted living, we recently invested in several facilities throughout the nation. Our investment in Sunrise Assisted Living in Sacramento, California illustrates the ripple effect it has on the lives of seniors, their families, and others in the community.

Most of the facility's residents have local family, and the convenient location allows them to visit without having to travel long distances. Ongoing contact with family contributes to the physical and psychological well-being of seniors. Family members also have the assurance of knowing that their loved one is receiving high-quality care.

The majority of residents lived in the area previously, and many have favorite stores and restaurants as well as established relationships with doctors. A community van enables residents to continue to frequent these businesses and contribute to the local economy.

The facility and its residents are active participants in the community. They cosponsor an Alzheimer's Walk and an annual "senior faire," which provides local vendors an opportunity to share information about products and services of interest to seniors. Residents are leaving behind a lasting legacy, as children from local schools visit frequently to hear stories about the past.

Sunrise Assisted Living offers seniors an attractive choice for assisted living and provides an outstanding investment return for our members.



affecting lives

calpers health & long-term care

Health Care Program:

Precedent-Setting Cost Restraints

Fiscal year 2003-04 was a watershed year in our long-term efforts to restrain escalating health care premiums, without trimming benefits or raising members' out-of-pocket fees. The course for change was set at the year's outset under the Strategic Plan for Health, our blueprint for long-term savings, improved quality and choice, and Health Program stability.

The strategic plan spawned a dozen initiatives, but none was as immediately vital as two ventures to restrain costs: an exclusive hospital network for CalPERS Blue Shield members and a regional pricing plan for contracting public agencies. Meanwhile, our self-funded health plans improved their financial reserves and the Long-Term Care Program added enrollees and built fiscal stability. Constituent advisory panels provided vital feedback on new proposals to improve the Health Program, and our new Health Care Decision Support System played a key role in negotiations leading to our first overall premium increase below double digits in four years.

No Change in Major Cost Drivers

While market cost trends were slowing in the Summer of 2003, CalPERS and other purchasers still faced the same forces that had sent annual premium increases soaring more than 50 percent since 2002. No single cure for the ailing U.S. health care system was on the horizon. Industry analysts predicted continued annual double-digit premium increases for the rest of the decade.

Our aging enrollees required more medical services. Many of them had costly chronic conditions that drove more than half of our program's annual spending. Consumer demand was strong for new diagnostic and treatment technology. Hospital prices accounted for almost half of annual premium increases, as consolidations in Northern California created near-monopolies. Direct-to-consumer prescription drug advertising spurred the demand for expensive brand name drugs.

We also faced potential erosion of our more than 1.2 million member risk pool because of the disparity in health care costs across the State. Our single Statewide premiums masked the fact that prices were as much as 40 percent higher in the North than in the South. Increasing numbers of South State contracting agencies found that they could get cheaper rates in their local markets. By mid-Summer, all or parts of 35 contracting agencies with 37,000 enrollees gave notice that they would leave the program on January 1, 2004.

Health Program Highlights

- 1,200,668 employees, retirees & family participants
- 61 percent are State members
- 39 percent are public agency & school members
- \$3.8 billion paid in annual health premiums

Blue Shield of California, our largest health maintenance organization (HMO), calculated that the departures would raise our costs by \$26 million in 2004. The HMO also warned that scores of southern agencies with as many as 65,000 more enrollees might leave the program in 2005 — unless we did something. Long term, the departures would have meant a disproportionate number of contracting agency enrollees in costly areas would be left in the risk pool, eventually raising prices even higher, year by year for everyone, North and South. This was averted because of a new regional pricing policy adopted by the Board.

Premiums for Basic plans in 2004 increased by 18 percent for HMOs, 13.2 percent for preferred provider organizations (PPO), and 11.6 percent for Association plans. Medicare Supplement plan premiums rose by 26.8 percent for HMOs. They declined 1.2 percent for PPOs and increased by 15 percent for Associations.

The 2004 rate package was in line with what analysts forecast for many other employer-based purchasers that year, many of whom had younger, healthier enrollees than ours.

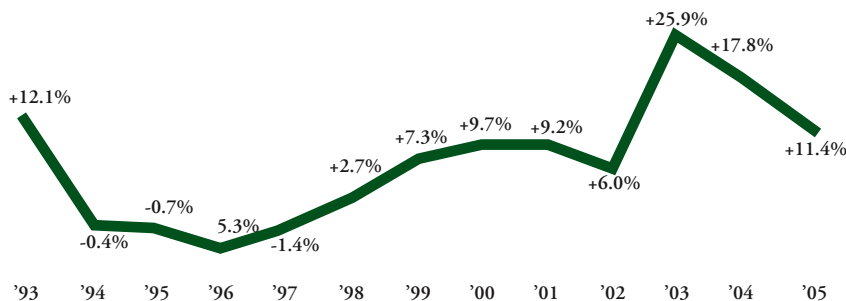
To obtain rate relief in 2005, we would have to move quickly to wring more savings from the program without compromising our policy imperatives of quality, plan stability, and access to services.

Exclusive Hospital Network

Proposals to reduce hospital costs and stem the loss of contracting agencies had been in the works for some time. In the Fall of 2003, we engaged large California hospital chains about some pricing options for the network serving more than 400,000 CalPERS Blue Shield members. Sutter Health, a 26-hospital chain in Northern California, rejected an option for a tiered network. Tiering would have required members to pay more to use hospitals in the non-preferred tier, but no copayments for preferred hospitals.

Basic HMO Premium Averages

Percent Decrease or Increase
Based on a weighted average of all CalPERS HMOs



32 CalPERS Health & Long-Term Care

Instead, Sutter Health offered 2005 rates that still would have left it, in some cases, at least half again more costly than other hospitals in its Northern California markets. We eventually rejected that offer, but most other chains expressed willingness to consider an exclusive provider network that would allow us to exclude relatively high-cost, or low-value, hospitals.

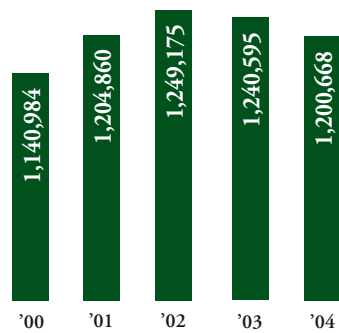
We moved ahead with Blue Shield on the exclusive provider network concept. To develop it, Blue Shield developed a model for comparing hospitals based on cost and quality. Two actuarial firms, Milliman USA and Reden & Anders, validated the methodology used to build the Blue Shield model, based on 2003 claims data for all hospitals in the HMO network. The results showed that Sutter hospitals were 60 percent more expensive than comparable Northern California hospitals and 80 percent higher than Blue Shield’s Statewide average.

Blue Shield proposed dropping 38 high-cost hospitals from its CalPERS network, beginning in 2005. It projected savings of \$36 million for that year and \$50 million a year thereafter, or as much as \$140 per year for a single premium and \$370 a year for the family premium for all CalPERS Blue Shield enrollees.

Most of the savings would come through excluding 13 Sutter hospitals since they accounted for more than half the HMO annual cost increases for hospitals serving CalPERS members.

The CalPERS Board adopted the exclusive network near the end of the 2003-04 fiscal year. Ten of the 38 hospitals originally excluded later rejoined the 2005 network after agreeing to meet cost and quality standards for their local markets. The State Department of Managed Health Care subsequently approved the network changes and directed Blue Shield to readmit four excluded hospitals to make sure members would have adequate access. Members whose doctors were affiliated only with excluded hospitals could retain those doctors by switching to PERS Choice or PERSCare, our self-funded preferred provider plans.

Total Health Program Membership
Five-Year Review



Regional Pricing Adopted for Public Agencies

Meanwhile, the CalPERS Board adopted a regional pricing plan for 2005. Local agency premiums (for those under age 65 people) would more closely reflect the actual cost of health care in five regions. Rates in the North would be a bit higher than the State's, but still competitive with the local market. Rates would range up to 19 percent lower than State rates in the South, and no more than 11 percent higher in the North.

The regional pricing plan stabilized the program since only 17 agencies decided to leave us in 2005. Many more new agencies signed on by the close of the 2003-04 fiscal year.

Premium Trend Relief

The Blue Shield provider network and the regional pricing changes helped moderate health premiums adopted in June 2004 for the following contract year. For the first time in four years, the overall Basic plan premium increase for under age 65 enrollees was held below double digits. Beginning January 1, 2005, premiums for all enrollees in HMO, PPO, and Association Basic plans would rise by an average of 9.9 percent and decline by more than 10 percent for Medicare supplement plans.

Basic plan premiums would cost 11.4 percent more for HMOs, on average, 6.4 percent more for PPOs, and 6.8 percent more for the Association plans. Medicare supplement premiums for HMOs would fall by more than 7.7 percent, 12.5 percent for PPOs, and by 0.5 percent for Association plans.

The rate package equaled or beat analysts' projections for employer purchasers in the U.S. marketplace in 2005. Unlike many employers, CalPERS held the line against benefit cuts and out-of-pocket member copayment increases.

The 2005 program also would include efficiencies in pharmaceutical administration to save \$11.5 million in costs. Blue Shield committed to enhancing drug management, education, and compliance for specialty and biotech drugs for certain diseases and promoting over-the-counter drugs when available as the first approach in treatment.

PPOs Continue to Post Gains

The System's self-funded preferred provider program reported successful completion of a three-year recovery project after substantially exceeding its fiscal goals. The objective for total program assets as of the end of 2003 was 4½ months of claims and expenses, or \$280 million to \$320 million. Actual plan assets totaled \$358 million, or \$38 million more than the target. PERSCare and PERS Choice Basic and Supplemental plans experienced significant positive cash flows in 2003 and finished the year with strong asset levels. To increase savings in 2005, PPO members will be asked to use mail-order services for maintenance drugs.

Improved Constituent Partnerships

We also broke new ground in our partnerships with our constituent groups. Following an imperative of the Strategic Plan for Health, we formed advisory panels for State and public agency members, and for members in underserved rural areas. These groups met regularly to review staff initiatives going to the Board and to seek consensus on alternative benefit designs, health care delivery ventures in rural areas, and other measures. They also considered formation of coalitions of employer and labor stakeholders aimed at increasing our collective bargaining leverage in rate negotiations with health plans and providers.

Gains for Service & Quality of Care

The annual *Quality Report*, published in the Summer of 2004, showed that 64 percent of CalPERS members were highly satisfied with their health plans, compared with a 61 percent satisfaction rate reported the previous year. The latest survey of 2,200 enrollees also found satisfaction rates of 73 percent for health care and 77 percent for doctors and that 89 percent of polled members would recommend their CalPERS health plan to others.

Heading into the annual Fall open enrollment, we made an unprecedented effort to help members find new health plans and physicians. For the first time, they could use a “Health Plan Chooser” link from the CalPERS Web site to compare rate plans in terms of costs, quality, and services, and to determine the availability of doctors.

In response to changes in the Blue Shield provider network, the HMO mailed letters to some 46,000 enrollees who had to choose new providers or switch to a PPO in 2005. Blue Shield also set up workplace “transition stations” to aid such members and explained their options through letters and phone calls. We also sent out letters, publications with articles about coming plan changes, and a brochure about member options.

Long-Term Care Program

Our popular Long-Term Care Program gained more than 2,300 enrollees during the 2003-04 fiscal year. More than 172,000 people were in the program at year’s end, paying annual premiums totaling approximately \$228.3 million and receiving more than \$51.6 million in benefits.

Long-term care covers personal, non-medical assistance in performing ordinary activities of daily living such as bathing, dressing, toileting, transferring to and from chairs, beds, or wheelchairs, eating, and continence.

Long-Term Care Program Highlights

- 172,792 participants
- \$1,321 average annual premium
- \$228.3 million in annual premium income
- \$51.6 million paid in benefits

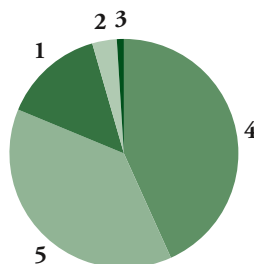
Our program provides three plan options: a Comprehensive Plan, a Facilities Only Plan, and a Partnership Plan. The Comprehensive Plan covers care at home or in the community, an assisted living facility, or a nursing home. The Facilities Only Plan covers care in a nursing home or an assisted living facility, and the Partnership Plan covers home and community care, assisted living, and nursing home care with a MediCal asset protection feature. Each plan includes care advisory services, respite care to provide short-term relief to normal caregivers, a premium waiver while receiving benefits, portability, inflation protection options, guaranteed renewal from year to year and hospice care.

At the close of the fiscal year, 73.1 percent of all enrollees were in the Comprehensive Plan; 22.5 percent were enrolled in the Facilities Only Plan; and 4.3 percent were in the Partnership Plan.

Although many companies provide for long-term care coverage, CalPERS offers the nation's first self-funded, not-for-profit long-term care program, with plans that are very competitive with the commercial marketplace. Premiums are paid by the individual and are based on their age when the application is received. Benefits are tax free, and portions of the premiums paid may be tax deductible under certain circumstances. The total coverage amount applies to all covered services, so members can use their benefits in whatever combination best meets their needs under the plan they choose. In addition, the deductible period is counted in calendar days — not days of paid service, enabling members to save potential out-of-pocket expense.

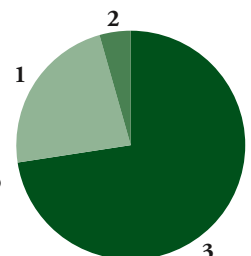
LTC Program Membership by Member Type

1. Active Employee Spouses - **14.5%**
2. Parents - **3.8%**
3. Siblings - **0.3%**
4. Active Employees - **44.0%**
5. Retirees & Spouses - **37.4%**



LTC Membership by Plan Type

1. Facilities Only Plan - **22.5%**
2. Partnership Plan - **4.3%**
3. Comprehensive Plan - **74.3%**



calpers investments

Transforming an Industrial Site Into a Community Resource



We are one of the largest participants in the California Urban Real Estate Program. The program's investment strategy is to develop urban infill areas and provide affordable housing in city hubs. Such projects provide attractive returns at minimum risk, while positively impacting the local community.

Our investment in Bay Street Emeryville in the Bay Area is having a positive ripple effect on the region's environment. The project began by transforming a dirty, unused industrial site into a valuable high-density, mixed-use property (residential over retail). Building residential and retail facilities on the same land is an efficient way to use our State's limited supply of land. The project's urban location enables people to live, work, and play in the same area, reducing traffic congestion and vehicle emissions.

The economic benefits of the project are also significant, as it brings much-needed affordable housing to the Bay Area. Additionally, by encouraging retail expansion in an underserved market, the project creates jobs and provides the local tax revenue needed to support public services.

The Bay Street Emeryville project has been cited as an example of how a city and the private sector can work together for the benefit of a community. Because of its success, our investment is expected to achieve high returns for our members.



benefitting the economy

calpers investments

Fund Delivers Double-Digit Investment Returns

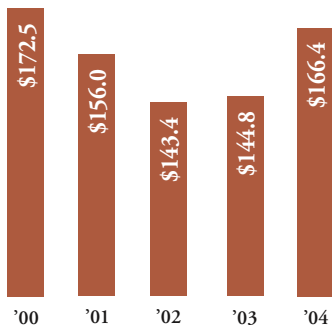
CalPERS earned a 16.6 percent return on our investments for the one-year period ended June 30, 2004, boosting overall market value to \$166.4 billion, and achieving double-digit returns that have not been seen since the mid-1990's.

More than \$22 billion in value was added to the Fund, of which \$2.3 billion was generated by taking advantage of unique market opportunities this past year. It set a record for special efforts taken by our investment staff.

We beat our benchmarks in four out of five asset classes, and did so while managing our risk and navigating through the ups and downs of the market last year. Even more important, our performance may help to reverse the past trend of rising employer contribution rates, which was caused by three years of low to negative investment returns.

Growth of Investment Portfolio

At Market Value
Five-Year Review
(Dollars in Billions)



Our top performing portfolio was our investments in corporate governance funds, earning an unprecedented 53.5 percent return.

Our U.S. stock investments returned more than 20.9 percent, exceeding the Wilshire 2500 benchmark of 20.6 percent. Our fixed income investments also performed well, earning more than \$900 million in additional value. International fixed income investments gained 8 percent, compared with its CitiGroup Non-U.S. Government Bond Index benchmark of 7.6 percent, while U.S. fixed income investments earned 1.4 percent, compared to the Citigroup Large Pension Fund Index that lost more than 0.8 percent.

Assets in our Alternative Investment Management Program, which specializes in private equity holdings, grew by 12.8 percent, exceeding its 9.7 percent benchmark.

Performance Benchmarks

Asset Class	Benchmark
Global Fixed Income	Citigroup Large Pension Fund Index Citigroup Non-U.S. Government Bond Index (Net Italy Tax)
Equity	
Domestic	PERS Wilshire 2500 Tobacco-Free Index
International	PERS SSGA Custom Index
Alternative Investments	Venture Economics Custom Young Fund Universe
Real Estate	NCREIF Property Index

Our real estate investments, which are largely office, retail, apartment and industrial assets, gained nearly 13.0 percent, exceeding the standard real estate index, the NCREIF Property Index which earned 9.7 percent.

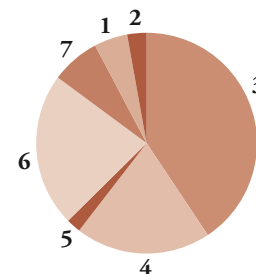
International stocks performed well earning a return of 29.0 percent, less than the System's benchmark of 31.7 percent. Absolute return strategies, or hedge funds, had a 9.8 percent return, falling short of a benchmark that returned 14 percent.

At the end of the year, 65.4 percent of the CalPERS portfolio was invested in equities, 25.4 percent in bonds and other fixed income, and 17.1 percent in real estate.

Allocation of Investment Portfolio

at Market Value \$166.3 Billion ¹
(Dollars in Billions)

1. Alternative Investments & Private Equity - **\$8.3**
2. International Fixed Income - **\$4.8**
3. Domestic Equity - **\$68.9**
4. International Equity - **\$33.6**
5. Cash Equivalents - **\$3.6**
6. Domestic Fixed Income - **\$38.2**
7. Real Estate - **\$12.1**



Note:

¹ Differences between investment values above and the values on the Summary of Investments on page 73 of the CAFR are due to differences in reporting methods.

CalPERS Asset Allocation

(Dollars in Billions)

Asset Class	Market Value	Current Allocation	Current Target ¹	Previous Target
Cash Equivalents	\$3.6	(2.1%)	0.0%	0.0%
Global Fixed Income	\$43.0	25.4%	26.0%	26.0%
Equity				
Domestic	\$68.9	40.7%	39.0%	39.0%
International	33.6	19.8%	19.0%	19.0%
Alternative Investments/Private Equity	8.3	4.9%	7.0%	7.0%
Total Equity	\$110.3	65.4%	65.0%	65.0%
Total Real Estate	\$12.1	7.1%	9.0%	9.0%
Total Fund	\$169.0²	100.0%	100.0%	100.0%

Notes:

¹ Target allocation effective January 1, 2004.

² Differences between investment values above and the values on the Summary of Investments on page 73 of the CAFR are due to differences in reporting methods. The Summary of Investments includes Net Investment Receivables/Payables.

Investment Policy & Strategy

Asset allocation is one of the most important decisions made by the CalPERS Board of Administration. In the long run, it is the way in which we diversify stocks, bonds, real estate, and other investments that determines our long-term performance. Studies have shown that approximately 95 percent of variation in investment performance of a pension plan is attributable to the asset allocation policy.

The asset allocation plan is the working framework for the selection and weighting of asset classes. The CalPERS Board sets a strategic asset allocation policy and a range around the target allocations. The allocation reflects that long-term outlook for each asset class. Our Board sets tactical asset allocation ranges that enable investment managers to take advantage of buying or selling opportunities and provides the flexibility for day-to-day management.

The CalPERS asset allocation mix is decided following an extensive review of a variety of factors. Economic scenarios of the global financial markets are simulated and future liabilities and expected future contributions by employers are considered.

CalPERS Investment Performance Goals

In addition to setting overall asset allocation policies, the Board also establishes investment policies for each portfolio and annual performance benchmarks for each asset class. Investment policies are formally reviewed through the Board’s Investment Policy Subcommittee and receive final approval by the Investment Committee. Our investment policies can be found on our Web site at www.calpers.ca.gov.

Alternative Investment Management Program

Our private equity investments, coined the CalPERS Alternative Investment Management (AIM) Program, hit a milestone during the year, generating more than \$6 billion in cash profits.

We maintained a high level of investment discipline by partnering with investment firms that had strong operational experience and could add value to our investment portfolio.

A Closer Look at AIM
Portfolio Diversification by Strategy

Portfolio Strategy	
Corporate Restructuring	40%
Distressed Securities	3
Expansion Capital	19
Mezzanine Debt	4
Secondary Interests	4
Special Situation	5
Venture Capital	24
Other	1
Total	100%

Approximately 85 percent of our new investment commitments were with top quartile funds. We took an opportunistic approach with the remaining 15 percent and targeted new or emerging firms with an emphasis on investments in the biotechnology, biopharmaceutical, media, and energy sectors.

One of our noteworthy accomplishments during the year was the creation of a new investment program that will invest up to \$200 million in the burgeoning environmental technology sector.

The CalPERS Environmental Technology Program targets investments in environmental technology solutions that are more efficient and less polluting than existing technologies such as recycling, minimizing the use of natural resources, and reducing emissions, refuse, and contamination to air, water, and land. We believe that environmental technology holds the promise to deliver attractive long-term investment returns while doing something positive on a global scale.

We believe our private equity portfolio is well diversified across sectors, and is positioned for continued growth and success. Our private equity partners have additional commitments of \$7.5 billion that we will deploy in the coming year. We can expect that some of the greatest opportunities will come from technology growth in California and in U.S. and international private equity opportunities.

Real Estate

CalPERS senior housing, single-family housing, retail, and apartment portfolios led the way with stellar performance during the year. Our senior housing portfolio yielded a 46.9 percent return for the Fund, while investments in the construction of homes returned 31.3 percent. Investments in strip malls and other retail establishments generated a 24.3 percent return, followed closely behind with a 22.6 percent return on our apartment portfolio.

Our primary investment strategy during the year was to reduce our core real estate holdings through the sale of assets at premium prices. At the same time, we increased our holdings in specialized investments like housing and California urban real estate, which presented more attractive market and return opportunities. These investments outperformed more traditional real estate investments and returned more than 21 percent for the Fund.

We made our first investment in Mexico during the year, investing \$50 million in Corporacion Inmobiliaria Vesta, a Mexican real estate company. The investment includes 18 buildings in industrial parks around the country that included such tenants as BMW, Delco Remy, Hitachi, Georgia Pacific, and Mars, Inc.

A Closer Look at Real Estate

Investments & Commitments (Dollars in Millions)

Portfolio	Market Value
Core Real Estate	
Office	\$2,527.4
Industrial	2,960.2
Retail	2,263.0
Apartment	1,136.9
Total Core Real Estate	\$8,887.5
Specialized Real Estate	
Natural Resources	\$551.0
Housing	1,090.0
California Urban Real Estate	204.7
Senior Housing	200.1
International	197.9
Opportunity Funds	19.0
Specialized Securities	1,121.6
Total Specialized Real Estate Portfolio	\$3,384.3
Total Real Estate	\$12,271.8¹

Note:

¹ Differences between investment values above and the values on the Summary of Investments on page 73 of the CAFR are due to differences in reporting methods.

To help guide our investments internationally and ensure that overseas markets are appropriate for real estate investing, we use a permissible market list for our international real estate investments. The policy ranks countries for potential real estate investment according to the examination of the markets’ political stability, transparency and labor practices, and it is consistent with our public markets policy. Under the new policy, we can invest in real estate in Brazil, Chile, Czech Republic, Hungary, Israel, Jordan, Mexico, Peru, Poland, South Africa, South Korea, Sri Lanka, and Taiwan.

The year was marked with some other notable investment and acquisitions. We invested in the construction of Plaza Lofts, an elegant seven-story building with 225 stylish lofts in downtown Sacramento, California. We launched a \$100 million development program to build on the last seven acres of vacant land in the downtown Anaheim, California core, bringing a mix of residential and commercial uses that complement the existing office and recreation facilities downtown. And we spent nearly \$25 million to purchase four rural properties in Oregon’s Polk and Yamhill counties that consist of 328 acres of land that we will convert into prime vineyards. Our strategy is to plant grapes then sell fully developed vineyards to wineries for premium prices.

Global Public Markets

Global Equity

Our global equity investments added more than \$103 million during the year to our fund as we focused on improving the capital allocation and structure of our portfolio.

We celebrated several accomplishments. Responding to recent trading scandals in the money management industry, we adopted a code of ethics for external managers and consultants that do business with CalPERS. The ethical standards address short-term trading by portfolio managers and other improper activities that threaten the security of our members’ assets. They are intended to ensure fair treatment, promote alignment of interests between CalPERS and managers, and establish a management structure in firms to handle conflicts.

We also selected 10 investment managers to be part of a pool that will manage up to \$6 billion in U.S. equity enhanced index strategies. The goal of our enhanced indexing program is to provide a higher return per unit of risk. It is a lower risk investment strategy that still uses an active investment approach. It will help us squeeze a little more active return out of our investment portfolio and round out our global equity investment strategy opportunity set. We

A Closer Look at Global Public Markets

(Dollars in Billions)

	Domestic	International	Total
Fixed Income	\$38.2	\$4.8	\$44.0
Equities	68.9	33.6	102.9
Total Global Public Markets	\$106.1	\$40.8	\$146.9

launched a search for investment managers to manage up to \$500 million in environmental investment strategies. And, we completed a search for two new advisors for our hedge fund program, hiring Pacific Alternative Asset Management Company and UBS to give us the flexibility to capture a broad universe of investment styles and strategies, and provide bench strength for added due diligence, monitoring, and management.

Finally, we added the Philippines, India, and Peru to our list of permissible emerging equity markets. The three countries made significant progress and demonstrated that they meet our high standards for investment. It was an example of our policy having a positive effect in the emerging markets. The Philippines was added after changes the country made to their laws and procedures. India and Peru moved to new global standards for trade settlement to settle trades one day after the trade date.

We still remain bullish on the equity markets, but will be taking a conscious approach to separate the sources of alpha and beta in our portfolio. We anticipate weeding out more active long-only equity strategies in the coming year and adding in a wide range of alternative asset classes to produce greater returns.

Global Fixed Income

All portfolios in our global fixed income program beat their benchmarks during the year. For the second consecutive year, domestic fixed income was on top delivering strong excess returns. U.S. fixed income added over \$1 billion in value to our Fund. The results were attributable to good decisions by our investment staff to underweight U.S. government bonds and place more emphasis on high yield investments and investment-grade corporate bonds.

International Equity & Fixed Income Investments Country Diversification

Up to \$25 million

Argentina	India
Cayman Islands	Peru
Czech Republic	

\$25 to \$50 million

Malaysia	Poland
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\$50 to \$100 million

Chile	Philippines
Luxembourg	Poland
New Zealand	

\$100 to \$300 million

Austria	Norway
Greece	Portugal
Hungary	South Africa
Ireland	Turkey
Israel	

\$300 to \$500 million

Belgium	Mexico
Brazil	Singapore
Denmark	Taiwan
Finland	

\$500 million to \$1 billion

Hong Kong	Sweden
Korea	

More than \$1 billion

Australia	Japan
Canada	Netherlands
France	Spain
Germany	Switzerland
Italy	United Kingdom

Success could also be found in our international fixed income program and securities lending program. Both programs generated \$98 million in added value for the Fund. We lent more than \$110 billion in global fixed income and global equities during the year to other institutional investors, including pension funds and mutual funds.

Corporate Governance

The year marked one of our most active and successful years as a shareowner and advocate for good corporate governance in our financial markets.

Our work began at the New York Stock Exchange. CalPERS, along with California State Teachers' Retirement System and the State Treasurer, called for the resignation of former New York Stock Exchange (NYSE) Chairman and CEO Richard Grasso, following the disclosure of Grasso's exorbitant \$188 million pay package. He resigned the next day, and the action paved the way for the NYSE to improve its operations to restore investor confidence. We continued to apply pressure to the NYSE and filed a lawsuit alleging that the Exchange purposefully allowed, and specialist firms participated in, trade manipulations, enhancing profits to both while shortchanging investors.

The Walt Disney Company and Michael Eisner were also targets last year. We participated in a campaign to reform Disney's governance and improve its performance. It resulted in a 53 percent withhold vote against Mr. Eisner, and he was later stripped of his chairmanship position. It also led to his resignation and we are hopeful that it will lead the addition of independent directors for the Walt Disney board and a new future for the company.

Our Board adopted a number of policies during the year to protect our members and the Fund's assets in the wake of malfeasance that rocked the investment banking industry. We adopted a set of mutual fund protection principles that call for a wide range of reforms to shareholder disclosures and reporting, mutual fund practices, and board structure. We adopted a set of investment protection standards for financial institutions that do business with CalPERS that requires firms to completely separate research from investment banking. And we campaigned for greater auditor independence, asking that corporations no longer use their auditor for consulting work. We were successful at several companies: Applied Materials, American Express, Gap, Unocal, Colgate, and Payless Shoe Source have all committed not to use their auditor for non-audit work next year.

Most importantly, we strongly supported a proposed rule by the Securities and Exchange Commission to allow shareholders to select and nominate corporate directors. The current means of director nomination available to shareowners are not adequate to address our concerns related to responsiveness, poor performance, and accountability. We believe accountability is at the heart of significant concerns with corporate boards. If passed by the SEC, investors will for the first time in history will be armed with an efficient and cost-effective way to nominate and elect independent, effective board members.

We kept the pressure on other companies in our investment portfolio as well. We released our Focus List of companies that represent some of the worst examples of poor financial and governance performance. This year's list included Emerson Electric Company, Maytag Corporation, Royal Dutch Shell Petroleum, and the Walt Disney Company.

We pushed a variety of corporate governance improvements at these companies in an effort to generate better returns and long-term performance. For example, we worked with one of our corporate governance managers, Knight Vinke Asset Management, to put pressure on Shell to improve their governance structure and independently audit their reserves. Shell changed its operating structure to include a single board of directors under a single chief executive officer.

During the year, we also played a greater role in stewarding good corporate governance principles in European markets. We mobilized support from other institutional investors when News Corporation announced it was going to export its legal headquarters from Australia to Delaware in a move that would have weakened shareowner protections. We spoke out and News Corporation agreed to make substantial improvements in shareowner protections.

The Role of California Investments

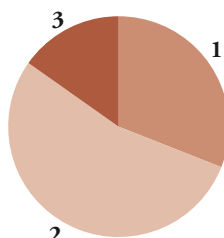
CalPERS investments are a critical part of the economic fabric of California. Our record of investing in California extends back to the early 1980s, with investments in real estate mortgages and real estate equity. As of June 30, 2004, approximately \$18.4 billion was invested or committed for investment in California.

California investments are part of each asset class in our investment portfolio and are expected to deliver a return commensurate with similar investments of comparable risk. Our Board considers California investments — and all other investments as well — on the sole basis of investment merit. Investments must be financially comparable to other available investment alternatives. The CalPERS Board judges comparability on a risk-adjusted basis. Under existing policy, we will accept no less in return, and may incur no additional risk or cost for a California-oriented investment.

CalPERS California Investments & Commitments

at Market Value \$18.4 Billion
(Dollars in Billions)

1. Real Estate - \$5.7
2. Equities - \$9.9
3. Fixed Income - \$2.8



48 CalPERS Investments

Investments in California may have the ancillary benefit of creating jobs, housing, and improvements to the State's general infrastructure, and more importantly, serve the broad interests of CalPERS members. By strengthening the State's economy and the well-being of our employers, California investments help promote the continued ability of employers to make contributions to the System.

Today, we invest nearly \$10.4 billion in companies that make their home in California. These include established, publicly-traded corporations and young entrepreneurial businesses that rely on CalPERS private placement capital for growth and expansion. Our fixed income assets, largely held in mortgage pass-throughs total approximately \$2.8 million. We have earmarked more than \$6 billion for housing, real estate development, and redevelopment in urban areas of California. And our Member Home Loan Program, implemented in 1989, has made more than 123,000 real estate loans, totaling more than \$19.4 billion.

CalPERS no longer produces a separate Annual Investment Report. All the information previously included in that separate volume is now contained in this Operations Summary and the accompanying Comprehensive Annual Financial Report. A complete listing of all portfolio holdings is available on the CalPERS Web site at www.calpers.ca.gov.

legislative update

Meeting the Needs of a Growing Region



Our investment in a 1,200-acre master-planned community, Whitney Ranch, in Rocklin, California is having a ripple effect on a growing Northern California region. The effect is widespread, as many of the local improvements necessary to build, the new community will benefit everyone who lives and works in the surrounding area.

Initially, construction of a new traffic artery will relieve congestion on a nearby freeway. Installation of a new water facility will resolve existing water pressure problems. And a new high school will alleviate overcrowding at the current school and provide for future growth in student population.

Because of its wise use of limited resources, this master-planned community will positively impact the region for decades. Whitney Ranch will include drought-tolerant landscaping, right-of-way access for neighborhood electric vehicles, and recreation and park facilities.

Finally, the community's 2,500 new homes, including a cluster of affordable condominiums, will help alleviate a housing shortage in the area. And, once people move into the homes, their purchases will contribute to the local economy.

Homes in master-planned communities are in high demand and sell quickly. It all adds up to a positive impact on the region and the potential for an excellent return on our investment.



creating communities

legislative update

State Legislative Update

This past year, CalPERS worked diligently to develop legislative positions and proposals that served the best interest of our members and employers. Through our collaborative efforts with interested stakeholders, we supported or sponsored legislation that provided improvements to our benefits or enhanced program design. The Board used its Legislative Policy Standards as a guide in formulating positions.

The following is a brief summary of some of the CalPERS-related legislation enacted during the 2003-04 Session of the California Legislature. (New laws become effective January 1, 2005, unless otherwise noted.)

A.B. 753, Chapter 440 (Leslie)

Current law provides health benefit coverage to the survivor of a safety officer who dies as the result of a work-related illness or injury, if married for one year prior to death. This bill provides this benefit for surviving spouses married for less than one year, as long as they were married prior to the onset of the illness or injury leading to the safety officer's death. (*Urgency measure, effective September 10, 2004.*)

A.B. 1875, Chapter 654 (Maldonado)

This bill corrects an oversight in the local agency retirement benefit formulas enacted by A.B. 616 (Chapter 782, Statutes of 2001) to specify that when an agency elects a formula, the formula will apply toward a member's entire service credit with that employer. Current law specifies that the formulas enacted by A.B. 616 only apply toward future service.

A.B. 2364, Chapter 266 (Correa)

Codifies the authority of State public pension systems to establish credit enhancement programs, subject to and consistent with, their fiduciary duty and the conflict of interest provisions of Section 503 of the Internal Revenue Code. (*Urgency measure, effective August 23, 2004.*)

A.B. 3094, Chapter 266 (Correa)

Adds an exemption to the provisions of the California Right to Financial Privacy Act to require financial institutions to provide CalPERS, CalSTRS, or the 1937 Act County Retirement Systems with information as to who had access to the funds paid to a deceased retiree's account after the date of their death.

S.B. 626, Chapter 69 (Soto)

Recodified the provisions of the Public Employees' Medical and Hospital Care Act (PEMHCA) in order to provide greater clarity. (*Urgency measure, effective June 24, 2004.*)

*S.B. 1105, Chapter 214**(Committee on Budget & Fiscal Review)*

Provides that new State employees will not make contributions to CalPERS nor receive service credit for their service, and the State employer will not make contributions on their behalf, during their first 24 months of employment. Requires those employees to make contributions to an Alternative Retirement Program during that 24-month period, after which the employees will begin contributing to CalPERS and earning service credit in the System. In months 47 to 49, the member can elect to receive the Alternative Retirement Program contributions as cash or transfer the accumulated contributions to CalPERS, and thereby receive service credit for that 24-month period. A member who does not transfer the accumulated contributions to CalPERS can later purchase the service credit at full present value cost.

This bill also extends the operation of the Rural Health Care Equity Program for State employees and retirees until January 1, 2008.

Federal Legislative Update

Although events in Washington, D.C. were largely dominated by international conflicts, our federal relations program maintained its focus on those issues that were critical to the System, our members, and our employers.

We continued our call for meaningful national health care reform. At a press conference announcing the National Coalition on Health Care's "Building a Better Health Care System: Specifications for Reform," the CalPERS Board President embraced the Coalition's view that the escalation of health care costs was not only a health care issue, but also a major national economic problem. Our federal representatives are working with key members of Congress to advocate control of ever-increasing health care costs and to improve the quality of the American health care system. In addition, we are working with other public sector health care providers to ensure that the public sector will have a significant voice during the 109th Congress in 2005-06.

A demand for corporate responsibility and accountability continued to guide us in our support of federal legislation and regulation. We testified before Congress presenting the System's views on the need for increased regulation of hedge funds and on the need for multinational corporations to be held to the same corporate governance standards as domestic companies. We also participated in a workshop conducted by the Securities and Exchange Commission (SEC) on the rule that would allow greater shareholder access to the election of corporate board members, an issue that remains a top priority for the System.

54 Legislative Update

We also called upon the SEC's new Office of Global Security Risk to assist institutional investors such as CalPERS, by requiring publicly-traded companies to disclose business they conduct in countries designated by the State Department as sponsoring terrorism.

Although numerous legislative proposals to improve public pension plans advanced in Congress over the last year, final action on a number of these issues is likely to await the Presidential administration and the start of the 109th Congress. Legislation is aimed at remedying IRS issues with benefit enhancements, early retirement windows, formula increases, and addressing other IRS concerns related to the purchase of service credit. We successfully lobbied the IRS to limit the impact of new minimum distribution rules on existing pension plan provisions and continue to monitor IRS regulations for the possible implementation of phased retirement benefits.

We continue to support the repeal or reform of the Social Security Government Pension Offset and Windfall Elimination Provision (WEP) that apply to the Social Security benefits or Social Security spouse/widows benefits of public employees who had employment not covered by Social Security. The most recent initiative on this topic, cosponsored by the Chairman of the House Social Security Subcommittee, advances a major modification of WEP. The cost of the Public Servants Retirement Protection Act, offered as a replacement of WEP, remains undetermined. The Social Security Protection Act of 2003 requires a new disclosure to employees not covered by Social Security. The notice will be prescribed by the Social Security Administration and will be provided to new employees by their employer.

Pension, Social Security, and health care issues are likely to be top priorities in Washington, D.C., as the economic and demographic impacts of the aging of the "Baby Boomer" generation continue to reveal themselves.

the year ahead

Environmentally Responsible Development of Vineyard Land



Developing land to produce premium grapes for the fine wine industry is a long process, and land with productive vineyards in operation can yield high returns. To take advantage of this opportunity, we partnered with Premier Pacific Vineyards, an investment company that specializes in vineyard development. Our investment includes 11 vineyard projects in California (and five in Oregon). Following a 7-10-year development process, the vineyards will be sold to wine producers.

Our approach to development is having a ripple effect on the environment that will endure for generations. This impact is the result of using “best management practices” in developing the land. For example, at one site in Napa County, our partner is working with local environmental concerns to repair previously damaged watersheds and restore the ecological balance of plants, insects, birds, and fish. We also contributed a portion of our land as a 30-acre wildlife corridor. The land was placed in a conservation trust, which will manage and protect it in perpetuity.

Along with Premier Pacific Vineyards, we are committed to being good stewards of the land. This environmentally sensitive approach increases the value of our properties.



investing in the environment

the year ahead

This Operations Summary included many of our accomplishments and achievements during fiscal year 2003-04. While the year was good for us, we are eager to tackle and embrace the new challenges and opportunities in the coming year.

In the next year, we will see more demand for services in our core business area. We will revisit our Strategic Plan, which guides us to continually improve our customer service, benefits management, and asset management, to meet demands of an ever-changing business environment, we will carefully assess how changes will improve our services. As we continue to streamline organizational planning and project management efforts, we'll also explore services that will provide more value to our programs.

We will work on merging the management of our Customer Contact Centers with our eight Regional Offices located throughout the State. This will provide a point of contact for our members for all e-mail, written correspondence, telephone, or in-person services.

We will also look to make enhancements to our self-service capabilities to our Interactive Voice Response system and expand our member online services capabilities through CalPERS On-Line. In the future, we hope to include online services for our members to check on the status of their retirement application or service credit purchase request online.

As we move forward, we will explore ways to make our customer service more efficient. One way is through our Regional Office Business Process Reengineering Project.

This project will include developing new and more efficient services and tools for our members and employers to learn about their benefits. In addition, we plan to offer multiple channels for members and employers to conduct their business with us.

In our benefits management area, we plan to implement a workflow project in pre-retirement and post-retirement death benefits claims to unify processing and improve effectiveness in delivery while supporting an increasing volume of claims.

We will continue to make improvements in our overall operations. We plan to work on the implementation of a new Regional Office business model that will enhance our ability to increase participation in our educational programs. We will also work on rolling out a new Customer Education Management System and employ a new process for survivor benefits that will achieve increased operational efficiencies and effectiveness in our services.

In addition, we will employ a new process that will show measurable reductions in our transaction costs in processing member retirement applications, service credit requests, customer correspondence, and beneficiary designations.

We also plan to continue providing educational workshops and seminars throughout the State and our retirement counseling services; however, we'll be focusing on ways to provide services that are relevant to career life cycles. We will also explore different communication channels to reach more members earlier in their working careers.

Moving forward, we will address an important issue as our membership experiences rapid growth towards retirement age. As this trend gains momentum, we recognize this will only continue to accelerate the demand for our core business and we must prepare for the additional strain on our workforce. In the months ahead, we will continue our work on establishing a formal succession plan designed to develop the future leaders of CalPERS. We will continue to support members of our staff who are considering advancement in their career path, easier access to learning, and training opportunities.

For our employers, our primary focus will be working further on the risk pooling of employer plans to help smaller employers reduce the fluctuations in their contribution rates. This year, additional effort will be focused on reducing asset-driven rate fluctuations. We will also focus on improved employer communication and education. We will survey employers for input as we seek to improve our programs and services that effect their own bottom line.

In the health care area, we will move forward with new and expanded strategic plan initiatives to restrain costs, improve plan stability, maintain member choice, and preserve access to quality care. We will focus on more in-depth analysis of data related to chronic conditions already identified as treatment priorities.

We also plan additional tools to help members make better-informed decisions about services for such conditions as chronic diabetes or acute breast cancer, and for their general health care needs. We will encourage health plan partners to develop new programs that give members incentives to make healthy lifestyle choices and explore ways to improve member access to health care in underserved rural areas.

We will continue to work with our advisory groups, comprised of State and public agency constituents, to seek benefit design improvements. Finally, we will retain our leadership role in State and federal health policy debates to secure fundamental reforms and restrain rising health care costs in California and in the nation.

In our investment operations, we will capitalize on the strengths gained by the amalgamation of our investment and administration arms to build new operating efficiencies and risk management capability.

Another focus will be implementing several phases of our environmental investment initiatives. We expect to make our first private equity investment in our Environmental Technology Program. We will hire investment managers to invest up to \$500 million in public companies that are environmentally friendly, and we plan to host a conference for other public pension funds and institutional investors to explore opportunities in environmental investing.

60 The Year Ahead

Most importantly, we will continue to push for reforms in Corporate America. Our top priorities will be tackling egregious executive compensation packages, greater independence on corporate boards, and pushing the SEC to adopt a proposed rule that would give shareowners the ability to nominate corporate directors.

We are always thinking ahead, but we never lose sight of what makes us a diversified, strong, and balanced System. Above all, our number one priority remains providing retirement and health security to all those we serve.

In the year ahead, we will work harder to provide better and more efficient customer services. As always, the exceptional commitment and talent of our employees around the State will drive our success.



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